Collection Process

Unit: Technical Skills

Problem Area: Financial Accounting and Reporting

Lesson: Collection Process

Student Learning Objectives. Instruction in this lesson should result in students achieving the following objectives:

1. **Collect payments and receivables.**
2. **Estimate uncollectible accounts.**

Resources. The following resources may be useful in teaching this lesson:

E-unit(s) corresponding to this lesson plan. CAERT, Inc. http://www.mycaert.com.

Ainsworth, Penne, and Dan Deines. *Accounting: An Integrated Approach*, 6th ed. McGraw-Hill Education, 2011.

"Control Account," *Accounting Tools®.* Accessed May 31, 2016. http://www.accountingtools.com/control-account-definition.

Cromwell, John. "What Is an Uncollectible in Accounts Receivable?" *Chron.* Accessed May 31, 2016. http://smallbusiness.chron.com/uncollectible-accounts-receivable-36309.html.

"Schedule of Accounts Receivable," *My Accounting Course.* Accessed May 31, 2016. http://www.myaccountingcourse.com/accounting-dictionary/schedule-of-accounts-receivable.

"Subsidiary Account," *Accounting Tools®.* Accessed May 31, 2016. http://www.accountingtools.com/definition-subsidiary-account.

Equipment, Tools, Supplies, and Facilities

- ✓ Overhead or PowerPoint projector
- ✓ Visual(s) from accompanying master(s)
- ✓ Copies of sample test, lab sheet(s), and/or other items designed for duplication
- ✓ Materials listed on duplicated items
- ✓ Computers with printers and Internet access
- ✓ Classroom resource and reference materials

Key Terms.

The following terms are presented in this lesson (shown in bold italics):

- accounting estimation
- accounts receivable
- collection agency
- collection process
- contra-account
- control account
- credit
- income statement approach
- invoice
- net realizable value
- on account
- payment
- receivable
- schedule of accounts receivable
- subsidiary account
- transaction
- uncollectible account

Interest Approach.

Use an interest approach that will prepare the students for the lesson. Teachers often develop approaches for their unique class and student situations. A possible approach is included here.

> *When a business sells a product or service to a customer and allows later payment, it is referred to as a receivable. This is common practice in business-to-business transactions, but it is rare in business-to-consumer transactions. Why? Allowing a customer to pay later is a risk because the customer may not pay what is owed. Uncollectible accounts are a normal part of doing business and must be accounted for appropriately.*

CONTENT SUMMARY AND TEACHING STRATEGIES

Objective 1: Collect payments and receivables.

Anticipated Problem: How are customer payments and receivables collected?

I. Onset of accounts receivable

A. Collection process

1. ***Payment*** is typically a transfer of currency via cash, check, electronic transfer (of funds), or assets to satisfy a promise to pay (compensate). The ***collection process*** is the methods a company uses to convert accounts receivable into cash. In other words, collection is the way a customer or supplier is prompted to pay the invoice sent by the accounting office. An ***invoice*** (or vendor invoice) is a bill sent by the seller to a buyer (customer or supplier) who has received goods and/or services on credit; it records a sale on account. An invoice contains the payee's name/company, the product or service name, quantity of the good or service, the agreed upon price, and a date on which the invoice is due.
2. A ***receivable*** is the amount due from a customer, supplier, or any other party and is considered a company asset (valuable possession). The term applies to all unsettled (unpaid) transactions or other types of monetary indebtedness (an amount owed to a company by its debtors or customers). Receivables are categorized as accounts receivable, notes receivable, etc.
3. ***Credit*** is the borrowing capacity of a company. A transaction in which payment will be accepted later is ***on account*** (e.g., "A customer purchased an item *on account*…"). Credits are recorded on the right side of a T-account. Customers must meet various requirements for a company to extend them business credit.

B. Sales transaction accounts

1. A ***transaction*** is a business event that changes asset, liability, or net worth accounts. Transactions are recorded in the appropriate accounting records. The accounts used in a sales transaction are Sales and Cash or Accounts Receivable accounts. A sales transaction affects a revenue account and an asset account.
2. ***Accounts receivable*** is a current asset account that reflects the balance of amounts owed the company by customers—an account for charge customers. Current assets result from selling goods and services on credit.
   a. Accounts receivable is a ***control account***, which is an account that stores the final balance of lower level balances (e.g., customer accounts). The

lower level balances that roll up to a control account are considered a ***subsidiary account***.

b. The journal entry for sales transactions paid with cash is a debit to the Cash account and a credit to the Sales account.

c. The journal entry for a sales transaction on account is a debit to the Accounts Receivable account and a credit to the Sales account.

3. On account payments

a. When payment is received from a customer *on account*, the entry is a debit to the Cash account and a credit to the Accounts Receivable account.

b. NOTE: The last entry eliminates the balance in the Accounts Receivable account, and the remainder is a debit in the Cash account and a credit in the Sales account.

C. Accounts receivable schedule

1. A ***schedule of accounts receivable*** is a report or a listing (generated by the Accounts Receivable system) that records each customer and how much each owes. The total of all accounts on the schedule must total the balance in the control account—accounts receivable.

2. The schedule can be modified (queried) to search for large amounts owed or for specific customers. This process is useful for generating notices regarding past due balances and for reviewing outstanding balances at various intervals (e.g., 30 days, 60 days, and > 120 days).

D. Unpaid accounts

1. Accounts that remain unpaid for an excessive period of time may be "written off" (removed from the books) or sold to a collection agency.

2. A ***collection agency*** is a business that purchases another company's receivables and assumes the process of acquiring payment.

Teaching Strategy: *Many techniques can be used to help students master this objective. Project VM–A and VM–B. Assign LS–A.*

Objective 2: Estimate uncollectible accounts.

Anticipated Problem: How are uncollectible accounts estimated?

II. Uncollectible account estimation

A. Uncollectible accounts

1. An ***accounting estimation*** is a type of cost control measure in which an approximate amount is calculated to be debited or credited for goods/services that have no precise way to be measured. Estimates are based on the accountant's judgment and specialized knowledge from past experience. Bad debt estimates usually mean the accountant must estimate the number of custom-

ers who will default on their accounts and the dollar value associated with those accounts. Accounting estimates rely on:

a. Historical information (numbers that rarely change)

b. Documentation (using the vendor contract to estimate numbers)

c. Personal calculations (notes from prior financial statements for use as a future reference)

2. An ***uncollectible account*** is an account receivable thought to have no chance of being paid. It is expected that a certain number of the customers granted credit will not pay their bills. Since this expectation is a normal occurrence of doing business, an entry must be recorded to estimate uncollectible accounts.

3. The entry is a debit to the Bad Debts Expense account and a credit to the Allowance for Uncollectible Accounts account. The Allowance for Uncollectible Accounts is a contra-account. A ***contra-account*** is an account that has a balance opposite of the normal balance; it reduces a related account on a financial statement.

B. Estimating uncollectible accounts

1. The ***income statement approach*** (for estimating bad debts) is a method of approximating uncollectible accounts by calculating a percentage of credit sales. In this method, the percentage is determined by analyzing past trends in unpaid credit sales. For example:

a. If a company determines 3% of credit sales are not collectible, the entry on credit sales of $100,000.00 would be a $3,000.00 debit to the Bad Debts Expense account and a $3,000.00 credit to the Allowance for Uncollectible Accounts account.

b. The asset account balance Accounts Receivable less the contra-account balance of Allowance for Uncollectible Accounts account is the net realizable value of Accounts Receivable. Therefore, ***net realizable value*** is the amount expected to be collected.

2. The Aging of Accounts Receivable account is another method of estimating the amount of bad debt. This account analyzes past due balances. An example of using this estimation method process is:

a. A company trends (a tendency to) the payment history of accounts between 30 and 60 days past due, 60 to 90 days past due, and so on. The percentage of accounts that go unpaid is applied to each time interval of past due accounts to arrive at the total of estimated uncollectible accounts.

b. The amount determined to be uncollectible is the *balance* of the Allowance for Uncollectible Accounts account. Should there be a balance in the account from a previous period, the entry is for the amount that brings the balance of the allowance account to the estimated amount.

Teaching Strategy: *Many techniques can be used to help students master this objective. Project VM–C and VM–D. As a class, calculate the amount of Accounts Receivable that will be uncollectible. Assign LS–B.*

- **Review/Summary.** Use the student learning objectives to summarize the lesson. Have students explain the content associated with each objective. Student responses can be used in determining which objectives need to be reviewed or taught from a different angle. If a textbook is being used, questions at the ends of chapters may be included in the Review/Summary.

- **Application.** Use the included visual master(s) and lab sheet(s) to apply the information presented in the lesson.

- **Evaluation.** Evaluation should focus on student achievement of the objectives for the lesson. Various techniques can be used, such as student performance on the application activities. A sample written test is provided.

Answers to Sample Test:

Part One: Completion

1. collection agency
2. on account
3. control
4. schedule of accounts receivable
5. credit
6. uncollectible account

Part Two: True/False

1. T
2. T
3. T
4. F
5. F
6. F

Part Three: Short Answer

1. Answers will vary slightly but should include a discussion of the reasons an Allowance account is set up for Uncollectible accounts that is similar to the following: Past due and Uncollectible accounts are a normal part of business. The expectation that 100% of customers will pay their bills in full is unrealistic. To reflect the amount of Accounts Receivable it is reasonable to collect (net realizable value), an estimated amount is recorded in the Allowance for Uncollectible Accounts account. The difference between the Accounts Receivable and the Allowance for Uncollectible Accounts account is the amount the business can reasonably expect to collect from customers.
2. Answers will vary slightly but should include a discussion of control and subsidiary accounts similar to the following: A control account summarizes the balances of all related subsidiary accounts. For example, each customer has a subsidiary account that organizes individual invoice information (date of sale, amount, due date) and the Accounts Receivable account reports only one total: the total of all customer accounts.

Sample Test

Name ______________________________

Collection Process

Part One: Completion

Instructions: **Provide the word or words to complete the following statements.**

1. A business that purchases another company's receivables and assumes the process of acquiring payment is a/an ________________________.
2. A transaction in which payment is accepted later is considered a/an ________________________ sale.
3. The account that stores the final balance of lower level balances is a/an ________________________ account.
4. A report that lists each customer and how much he or she owes is a/an ________________________.
5. A customer who is granted ________________________ may pay his or her balance at a later date.
6. A receivable that has no chance of being paid is a/an ________________________.

Part Two: True/False

Instructions: **Write *T* for true or *F* for false.**

_____1. The term "on account" means to pay later.

_____2. A schedule of accounts receivable account shows a listing of subsidiary accounts.

_____3. Accounts Receivable is considered a control account.

_____4. A receivable is the amount due from a customer, supplier, or any other party considered a company debt.

_____5. Uncollectible accounts are *not* a normal part of business.

_____6. The collection process is the methods a company uses to convert accounts receivable into debt.

Part Three: Short Answer

***Instructions:* Answer the following.**

1. Discuss the reasons an Allowance account is set up for Uncollectible accounts.

2. Explain what is meant by a control account and a subsidiary account.

SCHEDULE OF ACCOUNTS RECEIVABLE

ABC Company
Schedule of Accounts Receivable
December 31, 20—

Apples, Incorporated	19,500
Boysenberry Company	26,800
Cantaloupe Creations	14,200
Total Accounts Receivable	$60,500

VM–B

BAD DEBT JOURNAL ENTRIES

- January 3, 20—: Determine $10,000.00 of customer accounts are uncollectible.
  - *Record the expense as a normal part of business, and establish the Allowance account for writing off bad debt.*

Jan. 3	**Bad Debts Expense**	10,000	
	Allowance for Uncollectible Accounts		10,000

- January 10, 20—: Determine that ABC Company's account is not collectible. Write off $800.00.
  - *Write off the customer's account by removing it from the Accounts Receivable account.*

Jan. 10	**Allowance for Uncollectible Accounts**	800	
	Accounts Receivable		800

- February 25, 20—: ABC Company pays the past due account balance.
  - *Reinstate the customer account.*

March 20	**Accounts Receivable**	800	
	Allowance for Uncollectible Accounts		800

  - *Record the invoice payment.*

March 20	**Cash**	3,500	
	Accounts Receivable		3,500

AGING OF ACCOUNTS RECEIVABLE EXAMPLE

ABC Company	
Aging of Accounts Receivable	
December 31, 20—	
Age of Accounts Receivable	**Amount**
Current	$346,100
Past due: 1 to 30 days	$20,150
Past due: 31 to 60 days	$11,800
Past due: 61+ days	$14,425

UNCOLLECTIBLE ACCOUNT CALCULATION

ABC Company			
Aging of Accounts Receivable			
December 31, 20—			
Age of Accounts Receivable	**Amount**	**Probability of Non-Collection**	**Estimated Amount Uncollectible**
Current	$346,100	1.5%	
Past due: 1 to 30 days	$20,150	3%	
Past due: 31 to 60 days	$11,800	8%	
Past due: 61+ days	$14,425	30%	

Name ________________________________

Bad Debt: Uncollectible Account Journal Entries

Purpose

The purpose of this activity is to record the appropriate journal entries associated with uncollectible accounts.

Objectives

1. Review the transactions.
2. Determine the appropriate account to record each transaction.
3. Record the appropriate journal entries associated with uncollectible accounts.
4. Participate in a class discussion of recording uncollectible accounts.

Materials

- lab sheet
- class notes
- writing utensil

Procedure

1. Review your class notes about the collection process.
2. Review the transactions given. Determine the appropriate account to record each transaction. Then record the appropriate journal entry for each transaction.

January 5, 20—: Determine $15,000.00 of customer accounts are uncollectible.

Jan. 5			

January 15, 20—: Determine that XYZ Company's account is not collectible. Write off $3,500.00.

Jan. 15			

March 20, 20—: XYZ Company pays the past due account balance.

March 20			

March 20			

3. Participate in a class discussion of recording uncollectible accounts.
4. Turn in your completed lab sheet to your instructor.

Name ______________________________

Uncollectible Account Calculation Practice

Purpose

The purpose of this activity is to calculate the amount of uncollectible accounts using the Aging of Accounts Receivable process.

Objectives

1. Review the Aging of Accounts Receivable process.
2. Calculate the estimated amount of uncollectible accounts using the given percentages.
3. Enter the past due amount in the Estimated Amount Uncollectible column.
4. Participate in a class discussion of the Aging of Accounts Receivable table calculations.

Materials

- lab sheet
- class notes
- writing utensil
- calculator

Procedure

1. Review your class notes about uncollectible accounts. Review the Aging of Accounts Receivable process.
2. Complete the Aging of Accounts Receivable table.
    a. Calculate the amount estimated to be uncollectible for each past due interval using the Probability of Non-Collection percentages.

b. Enter the past due amount for each period in the Estimated Amount Uncollectible column.

Any Company			
Aging of Accounts Receivable			
December 31, 20—			
Age of Accounts Receivable	**Amount**	**Probability of Non-Collection**	**Estimated Amount Uncollectible**
Current	$450,000	1%	
Past due: 1 to 30 days	$26,500	3.5%	
Past due: 31 to 60 days	$18,000	10%	
Past due: 61+ days	$24,500	35.5%	

3. Participate in a class discussion of the Aging of Accounts Receivable table calculations.
4. Turn in your completed lab sheet to your instructor.